

MINUTES

MONTANA SENATE 58th LEGISLATURE - REGULAR SESSION

SUB COMMITTEE ON TAXATION ON SB 378 & SB 465

Call to Order: By **CHAIRMAN BOB STORY JR.**, on March 21, 2003 at 10:10 A.M., in Room 405 Capitol.

ROLL CALL

Members Present:

Sen. Bob Story Jr., Chairman (R)
Sen. Jerry W. Black (R)
Sen. Ken Toole (D)

Members Excused: None

Members Absent: None.

Staff Present: Lee Heiman, Legislative Branch
Andrea Gustafson, Recording Secretary
Shirley Herrin, Transcribing Secretary

Others Present: Sen. Sam Kitzenberg (R)
Sen. Royal Johnson (R)
John Morrison, State Auditor
Greg Petesch, Legislative Services Division
Brenda Thompson, State Auditor's Office
Dave Gibson, Governor's Office
Phil Thomas, Advantage Capital, Saint Louis
Andy Poole, Dept. of Commerce
Gene Walborn, Dept of Revenue

Please Note. These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Discussion On: SB 378 and SB 465

{Tape: 1; Side: A}

CHAIRMAN BOB STORY stated the committee would be discussing SB 378 and SB 465 and that the interested parties in both bills attempted to give the committee a better understanding about the difference in the bills yesterday. He said he understands the CAPCO program, or SB 378, targeted a type of program that would

give fairly definite tax credits for money that generates some venture capital inside the state, and that SB 465 was more of a long term, broader program, that at some point generates money back into Montana.

John Morrison has a sheet that is his interpretation of the features of the program. **EXHIBIT (tas60b01)**. He stated it is a pretty balanced review of the different kinds of programs, publicly funded, publicly managed, privately managed and CAPCO's and it is done by the rural policy research institute which exists at Iowa State University, the University of Missouri and the University of Nebraska. Iowa is kind of being a cousin of what we are proposing, Missouri being a CAPCO state and so presumably there should be some fairly balanced analysis and I thought I would just provide this to you for your identification.

John Morrison said they prepared some amendments that are responsive to **Mr. Scott Seacats'** concerns (legislative auditor). **Brenda Thompson** handed out the amendments **EXHIBIT (tas60b02)**

{Tape: 1; Side: A; Approx. Time Counter: 5.6 }

Brenda Thompson reviewed the amendments in detail with committee members posing questions throughout her presentation.

{Tape: 1; Side: A; Approx. Time Counter: 10.4 }

Dave Gibson explained the difference in a ten year treasury and a five year treasury are basically the yield curve is very flat. There is not a lot of difference so if you just take it to the ten year treasury you probably have roughly the same duration of the instrument and approximately the same risk.

The committee quizzed **Dave Gibson** at length regarding the return on people's investments. **Chairman Story** asked if there is a negotiated rate between the investor and this Capital Investment Board? **Dave Gibson** replied that was correct

Brenda Thompson continued with her review of the amendments. She stated there was a concern raised that there was a lack of oversight or concern that there needed to be more oversight of the entity that is selected to be the Capital Investment Administrator. So after discussing it internally we are suggesting that every three years the committee that does the selection of this entity shall actually continue in existence and every three years shall conduct the review of the Montana Capital Administrator, the entity that is overseeing the Fund Manager, the person that manages the fund of funds. Amendment 6 deals with issues that came out of that review and it states basically with every deficiency that the selection committee shall inform

the selected entity that is the Montana Capital Investment Administrator and then one year later there should be another review to determine if the deficiencies have been corrected. The committee questioned her at length regarding that section of the amendments.

{Tape: 1; Side: A; Approx. Time Counter: 21.0}

Brenda Thompson continued with amendment #7, which deals with the oversight and review of the fund manager. She responded to questions from the committee regarding the amendment.

John Morrison stated that Fund Allocation Managers contract should be subject to review every three years.

{Tape: 1; Side: A; Approx. Time Counter: 24.8}

Brenda Thompson said she had each calendar year for the amendment as thought the committee had discussed every year, so that would have to change. The committee discussed that amendment in detail.

{Tape: 1; Side: B; Approx. Time Counter: 0}

John Morrison said they envisioned a number of these issues would be dealt with in rule making. He said we do have a very open rule making process in Montana and it is our hope that we would be able to fill in these details with rule making but at the same time we are trying to address some of the concerns raised by **Scott Seacat**.

{Tape: 1; Side: B; Approx. Time Counter: 1.5}

The committee briefly discussed the name of the entity. **Greg Petesch** stated it is called a corporation in Iowa.

Brenda Thompson stated the next amendment addresses the desire to require at least 50% of the assets of the revolving fund to be invested in Montana. The committee discussed the amendment at length.

{Tape: 1; Side: B; Approx. Time Counter: 4.8}

Mr. Thomas said the CAPCO bill requires two full time employees with venture capital experience in the State. He said he would recommend a similar type of requirement.

Brenda Thompson continued with amendment #11, Page 12 which removes the provision that says the legislative auditor shall conduct an audit and provided for an independent auditor to conduct the audit of the Montana Capital Investment Administrator. The committee discussed the amendment regarding the audit at length.

{Tape: 1; Side: B; Approx. Time Counter: 8.3}

Dave Gibson said the State of Montana is part of the portfolio investment strategy and has millions of dollars invested in venture capital funds in the United States. They have got all the checks and balances they need to make sure they need to make sure that is a good investment so you have to make sure those blocks are checked but this isn't an insurmountable hurdle in defining audit and fiscal review policies.

{Tape: 1; Side: B; Approx. Time Counter: 10.2}

SEN. KEN TOOLE stated he was confident that the people that we have that are going to be involved in this are going to be reasonable people. The Governor's going to have an interest in this, the auditor is going to have an interest in this, and the Departments of Commerce and Revenue are going to have an interest in it. We are going to put reasonable people in these positions and I just don't think you need everything in Statute. This is a proposal that has the support of the Chamber of Commerce, the NFIB, the Local Economic Development Officials in the State of Montana, the Governors Economic Development Office, the Auditors office and the Department of Commerce.

John Morrison said he would like to point out, pursuant to the last question on Page 11, Line 13, Sub-section 3 of 21 says that "the fund of funds shall invest in venture capital funds with experienced managers or management teams with demonstrated expertise and a successful history in investment of venture capital funds."

John Morrison responded to questions from **SENATOR JOHNSON** that the investor would not receive the return on his investment. The Board would return the principal of the investment until at least 5 years from the date of the investment and so it would be a long term instrument.

{Tape: 1; Side: B; Approx. Time Counter: 20.6}

Dave Gibson explained if one investor put the entire \$50M in the program at the end of the ten year period he would be paid back an 8% per year return or some negotiated rate capped at 8% so he would be getting a \$4M a year profit. All of the entire \$50M would be paid back, plus 10 years of accumulated earnings, or seven to ten years, so he might get in the neighborhood of \$90M at the end of the program if it was one investor and one fund. He noted he was just simplifying it for conceptual purposes so if somebody puts in \$50M; then it is saying you should get \$90M back and if you only get \$50M back the State would make up the \$40M with tax credits and that investor would then be able to take \$10M a year off his tax return for four years.

{Tape: 1; Side: B; Approx. Time Counter: 22.4}

The committee discussed that one person could come in and invest \$50M and then that would be the end.

SEN. STORY stated that one of the legislative auditors concerns was there was no term of office on the capital investment board. **John Morrison** said the board members would be serving at the pleasure of the Governor and Auditor so each time the Governor and Auditor change they would have an opportunity to reappoint someone just like they do with the Board of Investments. After a brief discussion **BRENDA THOMPSON** said she could draw up an amendment.

CHAIRMAN STORY inquired what the committee wanted to do on this reporting issue on the venture capital. He asked if the Sub-Committee wanted to request an amendment that gets some reporting in there or leave it up to rule? The consensus of the committee was there should be some type of reporting.

CHAIRMAN STORY then asked where does the up-front financing come from for the operation of the board and that kind of thing?

JOHN MORRISON replied the fiscal note anticipates that they need an executive director and the secretary once they say that is \$187,000 in 2004 and \$97,000 in 2005. They are allowed to borrow that money from the Board of Investments for their start up costs. Their ongoing cost of operation is handled by the charging of placement fees so that when the CIB gets these institutional investors to put their money in they charge them a placement fee and that pays for the administration.

CHAIRMAN STORY then asked **SEN. KITZENBERG** to address SB 378 and his amendments.

SEN. KITZENBERG said he has two sets of amendments but he doesn't want to discuss them right now as he wants his expert witness to be able to talk more. **EXHIBIT (tas60b03)** Amendments for SB 378 1SB037802.alh, **EXHIBIT (tas60b04)** Amendments requested by **SEN. SAM KITZENBERG**.

CHAIRMAN STORY noted the committee was there to discuss the bill and the amendments. **SEN. KITZENBERG** replied he had asked the Department of Commerce and the Department of Revenue to draw up amendments and be here to explain them to the committee but they weren't here for the meeting. He said he would like to have **Mr. Thomas** go over some of these things and explain CAPCO and answer any questions you might have about CAPCO.

Mr. Thomas said he had just scanned through the larger set of amendments and most of them are grammatical and wording changes that don't have any substantial effect on the bill. **CHAIRMAN STORY** asked if he thought any of them were substantial. **Mr. Thomas** replied the only one that deserves a little more study would be the one on Page 1 Amendment No.2. He said he would have to refer that to our investment attorneys to take a look at and make sure it is ok. **CHAIRMAN STORY** inquired if that was the one that strikes sub-section 1. **Mr. Thomas** responded that was correct. He said the only fear they have is that this is very programmatic that we have the same bill in eight states and the insurance company ambassadors are very comfortable with it. If you make any kind of modification to the bill it looks as if it is a new bill to their attorneys. He explained the investment attorneys would ask the insurance company attorneys, and outside attorneys, so any changes in the bill end up having substantial review by multiple parties. So I don't know if I am in the position, in just a few seconds here, to say that would deserve some study. **CHAIRMAN STORY** responded, that is fine.

Mr. Thomas stated that on the second set of amendments, the second amendment would need some study also, but all of the others are probably OK. He said the idea is good on the second amendment but it may have an unintended consequence if a CAPCO made all of its investments and chose not to be de-certified. You could have open ended question where the fund technically still exists but if it decertified then retroactively you would have to go back 12 years and have people re-file their tax returns. That is why I need to study that a little bit more and make it doesn't have an unintended consequence. He said he could have some written comments on these amendments to the committee by tomorrow morning.

SEN. STORY replied that Monday would be fine. He told **Mr. Thomas** he could talk about his program while they were waiting for the people who drafted the amendments.

Mr. Thomas reviewed some materials he had. He gave an overview on how the money flows through the CAPCO? He said the way a CAPCO program would function, if Montana were to enact it this session, is you would have a short rule making period, approximately six months. The Department of Commerce would take applications from people that want to become CAPCO, which could be any qualified investor, people in-state or people out-of-state.

He continued explaining the concept of CAPCO to the committee in great detail.

{Tape: 2; Side: B; Approx. Time Counter: 0 - 1}

CHAIRMAN STORY asked **Gene Walborn**, Department of Revenue, to explain the amendments.

CHAIRMAN STORY questioned **Mr. Thomas** if in his experience would venture capital work in any states with 900,000 people population. **Mr. Thomas** replied he thought the state that is more applicable in being comparable is the State of Wisconsin. They have a \$50 million dollar program that they passed as a trial size program, they have had it in place for about 3 years now and they are proposing a \$100 million dollar addition to it this year.

CHAIRMAN STORY asked **Andy Poole** to go through a set of amendments on SB 378 that he had provided for **SEN. KITZENBERG**.

Mr. Poole reviewed the amendments in detail and responded to a lengthy period of questions from **CHAIRMAN STORY** and **Mr. Thomas**.

{Tape: 2; Side: B; Approx. Time Counter: 16.1}

Mr. Poole continued his review of the amendments.

{Tape: 2; Side: B; Approx. Time Counter: 19.6}

Mr. Poole continued with reviewing No.17 and No. 18 of the amendments and responding to questions.

{Tape: 3; Side: A}

Mr. Poole continued reviewing Nos. 26,27,28 and No. 29 of the amendments.

CHAIRMAN STORY noted that there needed to be a modification for clarity regarding when the ten percent credit is taken by the investor.

The committee then discussed **SEN. JEFF MANGAN'S** bill, SB 485.

Mr. Thomas explained SB 485 bill is a cross between two different concepts they have in Missouri where they have a tax credit program where individual investors can get a 40% tax credit for investing in a small business. He then responded to questions concerning the time frame for investing money.

CHAIRMAN STORY called for an adjournment to the meeting.

ADJOURNMENT

Adjournment: 12:10 P.M.

SEN. ROBERT STORY JR., Chairman

SHIRLEY HERRIN, Transcribing Secretary

RS/SH

EXHIBIT (tas60bad)